

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 19849
[REDACTED])	
)	DECISION
Petitioners.)	
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated August 31, 2006, asserting additional Idaho income tax, penalty, and interest in the total amount of \$42,067 for 2002.

The petitioners are nonresidents of Idaho. [Redacted] [Redacted] All of the income of [REDACTED] flowed through to the petitioners' income tax returns. [Redacted] had gains from the sales [Redacted] totaling \$921,200. They claimed the Idaho capital gains deduction with regard to these gains.

The auditor disallowed the entire amount of the claimed Idaho capital gains deduction. He contended that the petitioners did not qualify for this deduction because more than one-half of their gross income for the taxable year was not from [Redacted] operations in Idaho. The petitioners disagree.

Idaho Code § 63-3022H set out the authority for the deduction in question. It stated, in pertinent part:

Deduction of capital gains. -- (1) If an individual taxpayer reports capital gain net income in determining taxable income, eighty percent (80%) in taxable year 2001 and sixty percent (60%) in taxable years thereafter of the capital gain net income from the sale or exchange of qualified property shall be a deduction in determining Idaho taxable income.

(2) The deduction provided in this section is limited to the amount of the capital gain net income from all property included in taxable income. Gains treated as ordinary income by the Internal Revenue Code do not qualify for the deduction allowed in this

section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.

(3) As used in this section "qualified property" means the following property having an Idaho situs at the time of sale:

- (a) Real property held at least eighteen (18) months;
- (b) Tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise;
- (c) Cattle or horses held for breeding, draft, dairy or sporting purposes for at least twenty-four (24) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the Internal Revenue Code) for the taxable year is from farming or ranching operations in Idaho;
- (d) Breeding livestock other than cattle or horses held at least twelve (12) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the Internal Revenue Code) for the taxable year is from farming or ranching operations in Idaho; Underlining added.

The auditor asked the petitioners to establish that more than one-half of their gross income was from [Redacted] operations in Idaho. They failed to provide the documentation requested by the auditor. The petitioners' accountant responded, in part, as follows:

You have proposed to disallow Taxpayer's [sic] claim for a deduction for capital gains allowed by Title 63 Sec. 63-3022H on the basis that the underlying property did not qualify for the deduction under 63-3022H(3)(d). Your position is that not more than 50% of the taxpayer's [sic] gross income as defined under Internal Revenue Code Sec. 61(a) was from f[Redacted]Idaho. This is incorrect.

Your Notice of Deficiency further states that gross income for this purpose includes allocable gross income [from] all partnerships S-Corporations, and LLC's [sic] in which taxpayers were a partner or shareholder in during the tax year. We believe this is an improper and incorrect interpretation.

IRC Sec 61(a)(13) requires the distributive (emph. added) share of partnership net income or loss and extends to entities taxed as a partnership such as LLC's [sic]. It does not require the taxpayer to include a portion of the entities gross receipts or operating income in taxpayer's income. Not only would this be impossible in most situations of taxpayers having multiple investments in "pass-through" entities, it would require all of the calculations currently computed at the entity level to be done at the individual taxpayer level. Further, there is nothing in the Idaho Statutes or Regulations which would require a taxpayer to perform this calculation in computing Idaho Adjusted Gross Income.

Emphasis in original.

The Commission has reviewed the petitioners' positions and cannot agree with the conclusions reached by the petitioners' accountant. A partner in a partnership must include in his gross income his distributive share of partnership *gross* income, not *net* income as stated by the petitioners. Internal Revenue Code §§ 61(a)(13), 702(c).

A shareholder in an S corporation must include his proportionate share of the S corporation's gross income in the computation of his gross income. This is addressed in Internal Revenue Code § 1366(c) which states:

Gross income of a shareholder. In any case where it is necessary to determine the gross income of a shareholder for purposes of this title, such gross income shall include the shareholder's pro rata share of the gross income of the corporation.

Therefore, without the additional information requested by the auditor, but not provided by the petitioner, it was impossible for the auditor to determine whether the petitioner qualified for the deduction in question. This information has not been provided during the administrative appeal. Therefore, the Commission cannot determine at this time whether the petitioners are eligible for the deduction sought.

Taxpayers have the burden of proving that they are entitled to deductions. The U. S. Supreme Court stated:

Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.

* * *

Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

New Colonial Ice Co., Inc. v. Helvering, 292 U. S. 435, 440 (1934).

The petitioners have not carried their burden to show that more than one-half of their gross income during 2002 was from [Redacted] operations in Idaho. Therefore, the Commission finds that the auditor's determination must be affirmed.

WHEREFORE, the Notice of Deficiency Determination dated August 31, 2006, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER the petitioners to pay the following tax, penalty, and interest (calculated to April 30, 2007):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2002	\$32,213	\$3,221	\$7,692	\$43,126

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is included with this decision.

DATED this _____ day of _____, 2007.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2007, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]
[REDACTED]

Receipt No.
